In a deal-rich environment mid-market must try harder

Richard Young and Christopher Steed of Arthur Andersen Corporate Finance examine the rapidly changing relationship between banks and treasurers.

We are regularly told that big is better and that globalisation is becoming a key to 21st century success. This philosophy has clearly been taken up by the banking industry, which has witnessed a wave of mega-mergers and consolidation over the past few years. In the wake of this activity treasurers need to be more active than ever in managing the relationships with their bankers to ensure that they receive both the appropriate service and the best price possible for the products they buy. Similarly bankers need to ensure that they manage client relationships with care and do not allow themselves to be distracted by internal rationalisation, merger implementation or reorganisations.

Whereas the large corporates will be able to demand, and get, the best services from the ever-larger banking groups, the mid market company will have to try harder to achieve the right relationship with its bankers, especially at a stage when M&A and capital markets are heated and time is at a premium for both bankers and corporates.

Successful banking relationships are more than simply mutually satisfactory transactions. As with any relationship there must be a sense of trust which works both ways, an understanding of the boundaries of acceptable behaviour and a genuine willingness and real ability to resolve disputes given that bank and company will not always have congruent opinions or interests.

For all sizes of corporates these 'softer' elements to the relationship become increasingly important as industry concentration in the provision of financial services, more open capital markets and the rise of disintermediation all lead prices for core financial products to become similar across the industry. In such circumstances, acting proactively, service and being truly best in class will differentiate a finance provider. Being dynamic and reliable will differentiate a mid-market corporate.

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For the mid-market these soft elements are particularly important since such companies often face higher operational gearing than large corporates and thus need greater confidence and trust from their bankers.

The core bank relationship – a changing environment

Typically a mid-market company has and needs a core bank or banks with which it forms a close relationship. However, the core bank of the past may not be the right core bank for the future, especially after a mega-merger. There are two recent examples which may require the corporate to make a change:


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- a foreign owned lead bank is taken over by another foreign owned bank whose policies do not allow it to act as a lead bank in the UK; and
- the existing core bank reduces its appetite for the corporate's sector.

With the evolving strategies of the banks following mergers, or in response to others merging, the mid-market company now more than ever needs to ensure its core bank's strategy is consistent, where relevant, with the company's strategy.

Major strategic change within a company can also provide a catalyst for the treasurer to review a company's banking arrangements. At such times the opportunity can and should be taken to review a company's product needs across the entire spectrum of facilities, and currency and interest rate management products.

The treasurer, acting with a close understanding of the business strategy and development plans, should be able to formulate a matrix of banking, financing and hedging requirements over time and geography. This matrix can then be compared to the competencies of the existing core relationship group and it can be ascertained whether collectively or individually they remain the appropriate group to provide financial services to the company.

The lesson in the changing bank environment is the treasurer or finance director of the mid-market company should seek to reinforce his core relationships, while maintaining close associations with other banks as one would for any 'alternative supplier strategy'.

Mid-market corporates need to watch their covenants

At the heart of a successful relationship with a core group of financial services providers, will be committed facilities with sensible covenants and security structures.

One of the characteristics of a true core relationship rather than a transactional relationship is that the bankers will understand the company well enough to set appropriate covenants rather than use standard off the shelf provisions. The treasurer should attempt to ensure that the company will be able to act without the constraint of restrictive covenants and should anticipate, where possible, what changes to strategy or operations will lead to changes in funding. Of course the ideal situation is as few covenants as possible.

Companies should also aim to structure loan documentation such that the company can implement plans and strategies without the need to continually refer to a banking group for permission. This becomes particularly important if companies run into difficulties and need room to negotiate restructurings.

Good personal relationships – important as ever

At the heart of any banking arrangements will be the personal relationships that form between banker and customer. To facilitate healthy relationships, the treasurer can take some common sense steps that will be appreciated by finance providers. The first of these is to avoid unnecessary shocks or surprises to the banker.

Unfortunately it is a fact of life that smaller companies tend to give bankers more shocks than large ones. Developing predictability and delivering that which you promise will enable an environment of trust to develop. This is particularly true for growing companies or those hoping to increase the funding from their bankers.

Things do not always go to plan in business and very few companies enjoy an uninterrupted run of success. Bankers understand and appreciate this. What causes difficulty is when companies fail to give banks early warning of issues they are facing. When this happens bankers find themselves in a difficult position with their credit committees and loan management departments. The account managers then face embarrassing questions regarding their management of an account. This in turn leads to a breakdown of the relationship.

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In such circumstances, companies need to be aware of how they manage the flow of information to their bankers trying wherever possible to not give notice of a problem without accompanying it with a solution.

On a similar theme, giving bankers adequate time to respond to requests is key to a successful relationship. It is invariably the case that if you ask a funder for a quick answer on a new proposal then that answer will be no. Smaller companies tend to make decisions at a faster pace than the larger corporate. They should not expect that the banker will match their speed. From the company's perspective if a funder is going to say no to a proposal then the earlier this is done the better, a 'slow no' can be difficult for the treasurer.

It is wise for the treasurer to spend time understanding the reporting and credit structure of his bankers and their motivations. There is increasing evidence that decisions and timing are increasingly influenced by bank divisional targets and particularly individual bonuses.

The days when individual bankers made decisions about credits and relationships have passed, decisions in banks are made by groups of individuals or committees, and it is sometimes the case that the banking contact point for the treasurer has little decision making authority. It is also important for the treasurer to understand the logistics of their lenders decision making processes such as the dates and customs of the credit committee. The pre-lobbying of credit committees by account managers is now a widespread practice and one the treasurer can benefit from by understanding the credit process.

The impact of the new economy – have your answers ready

Experience tells us that bankers are increasingly unsure how to handle the e-commerce exposure of existing borrowers. Traditional bankers are reluctant to lend to start-up dot.coms but by lending to old economy companies who launch e-commerce ventures and those whose businesses are at threat from e-commerce ventures, bankers find themselves, whether they like it or not, exposed to the new economy.

Large corporates will have diversified enough activities and also will tend to have significant enough market positions and power to provide some comfort to their bankers in this area. The medium sized corporate will need to demonstrate to their bankers that they have impact assessments and viable strategies either to enter the e-commerce fray or to demonstrate that they will be able to resist the competitive threats. mid-market corporates need to prepare themselves for bankers questioning in this area.

Mid-market companies – waving not drowning

Mid-market companies need to try harder than larger ones across all of the elements of a banking relationship:

- at the start they need to grab the bankers attention with a viable, attractive funding proposition;
- in early stages they need to work hard at building trust, demonstrating reliability, developing predictability and delivering that which is promised;
- as a relationship develops they need to understand and remain in touch with potentially changing core bank strategies, focus, motivation and decision making processes; and
- they need to be mindful of the effects of the new economy and its impact upon their banking arrangements. ■

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